Investment Watch

4th Quarter, 2009

Half Empty or Half Full?

This rhetorical figure of speech embodies the uncertainty as we enter a new decade. The ***"Half Empty"*** faction need only look back at the *Great Recession* of 2008-09 and even longer back to the *"lost decade"* of the 2000s to justify their pessimistic view. The ***"Half Full"*** supporters must look forward and peer into their crystal balls to see a few *"green shoots"* of economic recovery which underpin their optimistic outlook for the future.

Psychologists can explain why many feel ***Half Empty*** today. We tend to overestimate the frequency, severity and duration of both bad and good events. The unprecedented financial losses of the last decade have worn us down making it hard to be optimistic. The *lost decade* was bookended by twin bear markets - 9/11 and the economic downturn when the Tech bubble burst and now the *Great Recession* precipitated by the subprime mortgage meltdown. The ten years just ended had the lowest GDP growth and was the worst decade in the US stock market history. Much to be pessimistic about!

Psychologists also say we tend to extrapolate the recent past into the future. Our recent past hasn't been very rosy. The loss of personal wealth due to the collapse of both the housing and stock markets along with unemployment over 10% which back in March made the prospect of projecting anything into the future depressing. Back then our glass was broken, almost empty. With feelings of hopelessness and helplessness, we wondered if our financial system would survive.

Our government and governments around the world coordinated their efforts with enormous economic stimulus to avert a financial collapse. Here at home our Federal Reserve Chairman, Ben Bernanke, used the resources of his office in unprecedented and unique ways to stop our glass from cracking. This is why Time Magazine named **Ben Bernanke 2009 Person of the Year**.

Time says, "*He knows that the economy is awful, that 10% unemployment is much too high, that Wall Street bankers are greedy ingrates, that Main Street still hurts...But Bernanke also knows the economy would be much, much worse if the Fed had not taken such extreme measures to stop the panic. It's no consolation to the 1 in 6 Americans who is underemployed, the 1 in 7 homeowners with a delinquent mortgage or the 1 in 8 families on food stamps, but there would be far more joblessness, foreclosures and hunger were it not for Ben Bernanke. But the main reason Ben Bernanke is TIME's Person of the Year for 2009 is that he is the most important player guiding the world's most important economy.* ***The decisions he has made, and those he has yet to make, will shape the path of our prosperity, the direction of our polices, our politics and our relationship to the world."***

Bernanke and the ***Half Full*** camp have a fragile sense that the worst is over. They know downturns must hit bottom before the long climb out can begin. Those ***Half Full*** followers feel that the market, the economy and the banks all hit panic enhanced bottoms back in March when our glass was almost empty. The last half of the year produced some green shoots of recovery.

The US stock market is almost exactly ***Half Full***. Today the S&P 500 sits very close to the 1121 midpoint between its Oct. '07 peak (1565) and Mar. '09 low (676). A 50% recovery from that devastating meltdown. Those peak-to-trough losses were so damaging to investor psyche, its hard for us to believe we are halfway back...but we still have a long way to go.

The Bureau of Economic Analysis reported that our economy did in fact hit bottom in the 1st quarter of 2009 when the Gross Domestic Product (GDP) contracted –6.4%. After a smaller contraction of –0.7% in the 2nd quarter, the GDP turned positive in the 3rd quarter to 2.2% and Macro Economic Advisors projects 4.1% growth in the 4th quarter. The recession is over, but our economy is still fragile and pessimism persists. Many wonder if the GDP gains were government and liquidity driven and if the economy can stand on its own once stimulus is removed?

As we bid adieu to 2009, handicapping the New Year is a fool's game when historic records fall so easily. The ***Half Empty*** pundits rightly worry about deficit spending, record unemployment, trade imbalance, dollar devaluation, commercial real estate decline and the consumer. While no one expects a rip-roaring recovery, the ***Half Full*** market seers foresee sustainable GDP growth due to a stabilization in the financial and housing markets and unemployment, as well as, abundant cash and liquidity with low inflation.

Half Empty or Half Full? No one knows. Time will tell, but let's all be thankful we still have a glass!

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4940 Washington Blvd.
St. Louis, MO 63108